

AMOCO PRODUCTION COMPANY

IBLA 75-340

Decided March 24, 1976

Appeal from a decision by the Acting Director, U.S. Geological Survey, affirming request of Acting Oil and Gas Supervisor that appellant submit corrected reports of gas production from the Federal leases which are subject to the Little Buffalo Basin Frontier Gas Sand Unit Agreement, I-Sec. No. 225, along with payment of additional royalty.

Affirmed.

1. Oil and Gas Leases: Unit and Cooperative Agreements -- Words and Phrases

"Area covered by unit plan" and "Lands committed and not committed to unit plan." When an oil and gas lease is committed to a cooperative or unit plan of development or operation approved by the Secretary, and when such plan unitizes less than all horizons or depths of said lease, the "area covered" by the plan consists only of the unitized depths or horizons and excludes any depths or horizons not unitized. Such a lease necessarily "embraces lands that are in part within and in part outside of the area covered by such plan" and must be "segregated into separate leases as to the lands committed and the lands not committed." "Lands committed" can only refer to all unitized depths or horizons; "lands not committed" refers to all non-unitized depths. 30 U.S.C. § 226(j). Solicitor's Opinion, M-36776 (May 7, 1969), no longer followed in part.

APPEARANCES: Harry O. Hickman, Esq., and Louis C. Ross, Esq., of Denver, Colorado, for appellant.

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Amoco Production Company appeals from a decision of the Acting Director, U.S. Geological Survey, dated December 19, 1974, which affirmed the determination of the Acting Area Oil and Gas Supervisor, Casper, Wyoming, that appellant should file corrected reports reflecting royalty calculations on all production allocated to each Federal lease in the Little Buffalo Basin Frontier Gas Sand Unit Area, and that appellant should pay any additional royalty that is due.

The controversy centers on the appellant's contention that gas from the unitized Frontier series of formations may be used royalty free for production purposes in other formations in the original lease area from which the gas is taken. The history of the agreement unitizing the Frontier series of formations dates back to the time when unit agreements were first authorized by an amendment to the Mineral Leasing Act of 1920. See Act of July 3, 1930, 46 Stat. 1007, 1008. This temporary authorization provided by the 1930 Act was later reenacted in permanent form. Act of March 1, 1931, 46 Stat. 1523, 1525. 30 U.S.C. § 226(j) (1970).

On January 6, 1931, the Secretary of the Interior approved the "Cooperative or Unit Plan of Development, Little Buffalo Basin, Wyoming, I-Sec. No. 225," to which Federal oil and gas leases Cheyenne 044187, 044193, 045633, 045855, 052234, 052235 and 052236 were committed for the purpose of developing the gas in the Frontier series of formations. 1/ Article V of that agreement provides as follows:

That this cooperative or unit plan of development shall apply only to deposits of gas from the Frontier series * * * [within the designated area]; deposits of gas from other sands, and deposits of oil from any and all sands being expressly excluded from the force and effect of this agreement.

While the original leases excepted from royalty payment to lessor the "oil and gas used for production purposes" on the leased land, the Frontier Gas Agreement established a sliding scale royalty for gas and made no reference to gas used for

1/ This agreement is identified as the "Little Buffalo Basin Frontier Gas Sand Unit, I-Sec. No. 225," and hereinafter is referred to as Frontier Gas Agreement.

production purposes. Prior to August 25, 1940, the expiration date of one of the leases which had been joined in the Frontier Gas Agreement, the operator under the agreement sought a declaration of recognition by the Department of the extension of the leases included in the agreement in their entirety, and as to all formations and production, beyond their initial 20-year terms, for as long as the unit plan continued in effect. The statute provided that:

* * * any * * * lease that has become the subject of a cooperative or unit plan of development or operation * * * shall continue in force beyond said period of twenty years until the termination of such plan.

Act of August 21, 1935, 49 Stat. 674, 677.

The Assistant Secretary replied favorably in a letter dated August 3, 1940:

* * * No leases have ever been granted for the same tract of land which provided for the development of the oil deposits as distinguished from the gas deposits, or for the development of one formation as distinguished from another formation.

It follows from the foregoing that the leases committed to the unit plan for the Little Buffalo Basin field will be considered as extended beyond their twenty-year period for so long as the unit plan remains in effect, and that operations may be conducted in all formations and sands and for the development of oil or gas, except as to the formations known as the Frontier series, independently of the terms and provisions of the plan.

An agreement entitled "Little Buffalo Basin Unit Agreement, Deep Sand Unit I-Sec. No. 365," was approved on September 7, 1943, which effectively unitized the remaining lands within the leases in question, but expressly excluded the Frontier series of formations. 2/

While the Deep Sand Unit Agreement describes the unitized area without any reference to specific formations or horizons,

2/ This agreement is identified as the Little Buffalo Basin Deep Sand (Oil) Unit Agreement, and hereinafter is referred to as Deep Sand Agreement.

Article 3 expressly excludes gas from the Frontier formation from the substances unitized by the Deep Sand Agreement:

3. UNITIZED SUBSTANCES: All oil, gas, natural gasoline, and associated fluid hydrocarbons within the unit area in any and all sands or other formations hereinafter called "unitized substances", are unitized under the terms of this agreement, in manner and form herein set out. Provided, however, that the gas production from the beds comprising the Frontier Formation in said field embraced within the Frontier Gas Unit is expressly excluded from the operation of this agreement, and shall be and remain subject solely to the Frontier Gas Unit, and nothing herein shall be deemed to alter, change or modify the terms, conditions, force and effect of said Frontier Gas Unit * * *. (Emphasis supplied.)

Article 3 further provides that the Frontier Unit may be merged with the Deep Sand Unit as a separate participating area if "it shall seem feasible and practical so to do," and if so, merger would not change or alter the method of allocation of production under the Gas Unit. However, such merger has never been requested so the units remain separate.

On February 5, 1973, the District Engineer, U.S. Geological Survey, Thermopolis, Wyoming, wrote appellant, as operator under both agreements, a letter which noted that the Frontier Gas Unit produced 774,680 MCF during 1972, but reported sales of only 436,669 MCF, and requested an explanation for "this considerable difference between production and sales." Appellant's Area Superintendent made the following reply by letter dated April 6, 1973:

As you are no doubt aware, LBB Frontier Gas Unit leases which also have LBB Deep Sand Unit oil production are considered to consume gas on the same lease, hence no royalty has to be paid on this gas.

Of the eight LBB Frontier Unit leases, six have Deep Sand Unit oil production. Thus any gas produced from leases, State Land Tract 41 and Buffalo No. 20, the two with no Deep Sand Unit oil production, would have to be reported as gas production requiring royalty payments. There is also some gas produced from the other six leases which crosses lease boundaries via lease consumption, or sales to other companies and outside parties. This gas

has to also be reported as production requiring royalty payments.

A study was conducted by our General Office in Tulsa and it was determined that 15.2% of the produced gas was consumed by other leases in the Little Buffalo Basin Field. Thus, the reported production on our Form 996, Monthly Production Report, is total gas produced from all eight LBB Frontier Unit Leases. The sales reported is only that gas from the two LBB Frontier leases with no Deep Sand Unit oil production, or gas crossing lease boundaries (15.2%), or gas sold to other companies or other outside parties. That is, we report sales as only that gas which is subject to royalty payments.

After a series of letters, the Acting Oil and Gas Supervisor on November 12, 1973, renewed the request for corrected production reports and royalty payments. That decision was affirmed by the Acting Director of the Geological Survey, and this appeal followed.

Survey's decision seems to be based on two discrete theories, each of which alone would be sufficient to sustain that decision. Appellant attacks both theories. One theory is that the royalty provision for gas in the Frontier Gas Agreement amends the gas royalty provisions in the original leases and constitutes the entire agreement with respect to gas royalties, with the result that there can be no royalty-free use of gas for production purposes because there is no provision for this in the unit agreement. The second theory is that gas cannot be transferred free of royalty from one unit to another. This second theory is based on the principle that a unit agreement which establishes horizontal and vertical boundaries and limitations as to product segregates each lease into two new leases: one lease consisting of the land (or horizon) committed to the unit; the other consisting of the remainder of the original lease. If this principle is applicable to the case which is the subject of this appeal, then royalty is due on any gas which leaves the unitized Frontier formation because when it leaves the formation, it leaves the unit, thereby crossing a lease boundary.

The requirement that leases which become partially committed to unit agreements be segregated into two leases as described above is set forth by a 1954 amendment to the Mineral Leasing Act. Act of July 29, 1954, 68 Stat. 583, 585. The 1960 amendment extended this requirement to any lease which had theretofore been committed to a unit plan. Act of September 2, 1960, 74 Stat. 782, 784.

Appellant contends that "subsequent amendments of the Mineral Leasing Act of 1920 cannot affect established leases committed to the Frontier Cooperative Plan after its effective date." (Statement of Reasons, P. 11). This contention does not persuade us to ignore the plainly stated mandate from Congress that:

* * * Any lease heretofore or hereafter committed to any such plan embracing lands that are in part within and in part outside of the area covered by any such plan shall be segregated into separate leases as to the lands committed and the lands not committed as of the effective date of unitization. (Emphasis supplied.)

30 U.S.C. § 226(j).

Contrary to the appellant's contention that nothing in the Act authorizes "horizontal or vertical severance of a lease by virtue of a lease's commitment to the [Frontier Gas Plan] or the Deep Sand Unit," (Statement of Reasons at 13) we hold that the Act not merely authorizes but requires such severance of the lease.

An analysis of the statutory language will make clear the reasons why horizontal segregation is required when less than all horizons are unitized under the same agreement. The Act requires segregation of lands within "the area covered by any unit plan" from lands outside of that "area." To assist in the construction of the quoted phrase, it is helpful to refer to the terms in the statute which declare what may be unitized:

For the purpose of more properly conserving the natural resources of any oil or gas pool, field, or like area, or any part thereof * * *, lessees thereof and their representatives may unite with each other, or jointly or separately with others in collectively adopting and operating under a cooperative or unit plan or development or operation of such pool, field, or like area, or any part thereof * * *. (Emphasis supplied.)

30 U.S.C. § 226(j).

The question which arises is whether the quoted language refers to depths as well as surface areas. This language can be interpreted to authorize the unitization of a single formation, construing these emphasized words as referring to depths as well as surface areas. The fact that the Department has

long considered this language to authorize the unitization of specific horizons is evidenced by the Secretary's approval of the Frontier Gas Agreement in 1930.

Similar construction must be given to the 1954 amendment requiring segregation of leases "committed to any [unit] plan embracing lands that are in part within and in part outside of the area covered by any such plan." Accordingly, if horizontal unitization is authorized, horizontal segregation is required.

Appellant relies on the August 3, 1940 letter from the Assistant Secretary, quoted above, to show that no segregation can be effected in this case. The only effect of that letter was the extension of the terms of the non-unitized portions of the leases which had joined the Frontier plan. Our decision does not revoke that extension. The rationale of the Assistant Secretary's decision is indicative of a Departmental policy that remained in effect until the 1954 amendment was enacted, even though the Bureau of Land Management, for administrative purposes, had earlier begun to segregate leases partially unitized. The Opinion of the Chief Counsel, Bureau of Land Management, Extension of Oil and Gas Lease Term by Production (December 18, 1953), expressed the view that such segregation does not affect the terms of the lease. It was this opinion that led to the request for the legislative provision for lease segregation upon unitization that appeared in the 1954 amendments to the Mineral Leasing Act.

It is useful to note that the Department has found that the Mineral Leasing Act permits the assignment of less than all horizons of a lease. Continental Oil Co., 74 I.D. 229 (1967). By analogy, horizontal unitization may also be approved but this requires horizontal segregation of the leases. W. C. McBride, Inc., Wyoming 022669, March 29, 1968.

The situation leading to McBride arose when the Land Office indicated that segregation because of partial commitment of lease 022669 to a unit agreement had been effected along vertical lines, following the surface subdivisional lines of the unit area. The subject unit agreement included only certain shallow formations, so that the vertical segregation included in the unitized lease 022669 some production from deeper non-unitized formations, and the newly-segregated lease 0324703 was indicated as a lease subject to payment of rental without benefit of any production. The Land Office ruled that the royalty from the deep non-unitized production could not be applied to the account of the segregated lease. From this ruling McBride appealed.

The Chief, Office of Appeals and Hearings, Bureau of Land Management, ruled that the Wyoming State Office had improperly included the non-unitized producing formation in the same lease as the unitized horizons. In construing the segregation provision in § 17(j) of the Mineral Leasing Act, 30 U.S.C. § 226(j), McBride held:

The only segregation provided for in the above provision is segregation into separate leases of lands committed to the unit plans and lands not committed. In the present case, only formations above the top of the Minnelusa formation have been unitized and thus committed to the unit plan. The only area covered by the Rocky Point Shallow Agreement comprises the particular formations subject to the agreement. The unit area, therefore, can only include the unitized formation; it cannot include the area beneath the bottom of the unitized formations.

Accordingly, it follows that there should have been a segregation into one lease of that portion of the original lease included within the unitized formations, that is, all the formations lying above the top of the Minnelusa formation within the unit area, and into a separate lease of the entire remainder of the original lease, including the production underlying the unitized formations. 3/

3/ In response to questions posed by Robert B. Laughlin, Esq., of the Rocky Mountain Oil & Gas Association, concerning the possible effects through horizontal segregation of leases, as well as to a request for reconsideration of McBride, Solicitor's Opinion, "The Segregative Effect upon a Federal oil and gas lease of a partial unitization embracing less than all formations, horizons or strata, or limited to a particular depth, interval or zone within the exterior boundaries of the lease," M-36776 (May 7, 1969), was issued by Thomas J. Cavanaugh, Associate Solicitor for Public Lands. In the Opinion, the Associate Solicitor reaffirmed the propriety of horizontal segregation expressed in McBride, where one lease embraced only the unitized formations and the other embraced the deep horizons and the entire vertical extent of the leased lands outside of the area boundaries of the unit. The Opinion also stated that whether partial unitization of less than all formations within the boundaries of a Federal oil and gas lease effects horizontal segregation of the parent lease into two leases, one of which embraces only the unitized formations, depends upon the intent

In Buttes Gas & Oil Company, 13 IBLA 125 (1973), this Board adopted the construction of the segregation provision of § 17(j) set forth in McBride. Buttes involved a fact situation closely resembling that in McBride, and that decision held improper a segregation which included a non-unitized producing formation along with unitized formations in the same lease. This appeal gives us no reason to abandon our construction of the statute.

[1] Accordingly, we hold that when an oil and gas lease is committed to a cooperative or unit plan of development or operation approved by the Secretary, and when such plan unitizes less than all horizons or depths of said lease, the "area covered" by the plan consists only of the unitized depths or horizons, and excludes any depths or horizons not unitized. Such a lease necessarily "embraces lands that are in part within and in part outside of the area covered by such plan" and must be "segregated into separate leases as to the lands committed and the lands not committed." "Lands committed" can only refer to unitized depths or horizons; "lands not committed" must refer to all non-unitized depths. When a unitized substance is removed from the unit area, royalty is due even though the product may be used for production purposes on the non-unitized lease that had been segregated from the unitized lease, this despite the fact that the parent lease provided for royalty-free use of the product for production purposes on that lease.

Because we hold that each lease originally committed to the Frontier Gas Agreement has been segregated into new leases, one lease consisting of that portion of the original lease within the Frontier series of formations and the other lease consisting of the remainder of the original lease, we find nothing in the record

fn. 3 (continued)

of the parties to the unit agreement, the facts and circumstances of the unitization, and the understanding of the Secretary or his designate when approving the unit agreement as to the reasons for and goals to be attained pursuant to such unitization. We find no authority in the statute to withhold the effects of segregation of a lease partially committed to unit agreements merely because the parties did not wish for such results. While, as in the instant case, there was no statutory mandate to segregate the partially committed lease when the LBB Gas Unit was effected, or even when the LBB Deep Unit was approved, the 1960 Amendment uses the word "heretofore" in its mandatory direction to segregate leases when not wholly committed to an approved unit agreement. Therefore, to the extent that the Solicitor's Opinion, supra, indicates that the intent of the parties can override the statutory mandate, we doubt that it is an accurate statement of the law.

that discloses any use of gas for production purposes on the same lease from which the gas was removed. The record does not indicate any controversy involving the royalty-free use of gas for production purposes within the unitized Frontier formation. Therefore, we do not reach the other issue developed below whether the Frontier Gas Agreement amended the royalty provisions of the original leases with the effect that gas could no longer be used royalty-free for production purposes on the lease from which it was produced.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision of the Acting Director of the Geological Survey is affirmed.

Douglas E. Henriques
Administrative Judge

We concur:

Martin Ritvo
Administrative Judge

Frederick Fishman
Administrative Judge

